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Controlled Burn

Palm and Soy Oil Demand Gain New Energy

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Summary

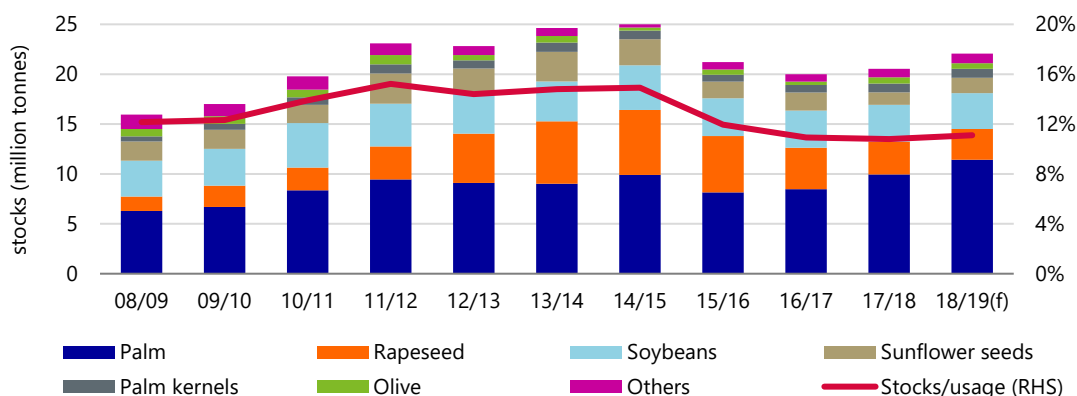
The flood of global vegetable oil has slowed over recent months, courtesy of historically low prices and record biodiesel demand. Since April 2018, leading demand indicators such as POGO (the Palm Oil-Gas Oil price ratio) and the B-100 FOB Midwest vs on-highway Diesel price ratio¹ have tilted in biodiesel's favour. Biodiesel's bargain status has accelerated global consumption of palm oil and soy oil, which account for over half of its feedstock². In 2019, Rabobank expects global vegetable oil demand growth of 3.5% and increased biodiesel mandates in exporters Brazil and Indonesia to set the stage for a lasting recovery in CBOT Soy Oil and MDE Palm Oil.

Two-year global vegetable oil glut under pressure

In the two years since El Niño drought cut through South-East Asia's palm oil region, global vegetable oil supplies have ballooned by over 10%. Growth has been led by palm oil production in Indonesia and Malaysia, where overexpansion and increases in prime yielding palm trees combined to bloat global stocks by +25% from 2016. Today, palm oil accounts for half the world's vegetable oil stocks yet only one-third of production. Global soy oil stocks also grew last year, particularly in the US (2017/18 +16% YOY), where record amounts of soybeans were crushed for soymeal to replace Argentina's supply shortfall.

Heavy supplies contributed to MDE Palm Oil and CBOT Soy Oil 2018 price performances (down ~15% YOY) and drove discounts to Brent to four-year lows last October. That discount has narrowed recently amid a fall in Brent and the more supportive outlook for vegetable oil remains well below the five-year average. Looking ahead for 2019, Rabobank expects a permanent price rebound from 2018 lows on the confluence of slowing production growth, export constraints, and record biodiesel demand.

Figure 1: Global vegetable oil (mainly palm oil) stocks still growing, but stocks/use almost flat³



¹ Biodiesel-National Ag Energy Roundup, USDA-AMS, US DOE, EIA, 2018

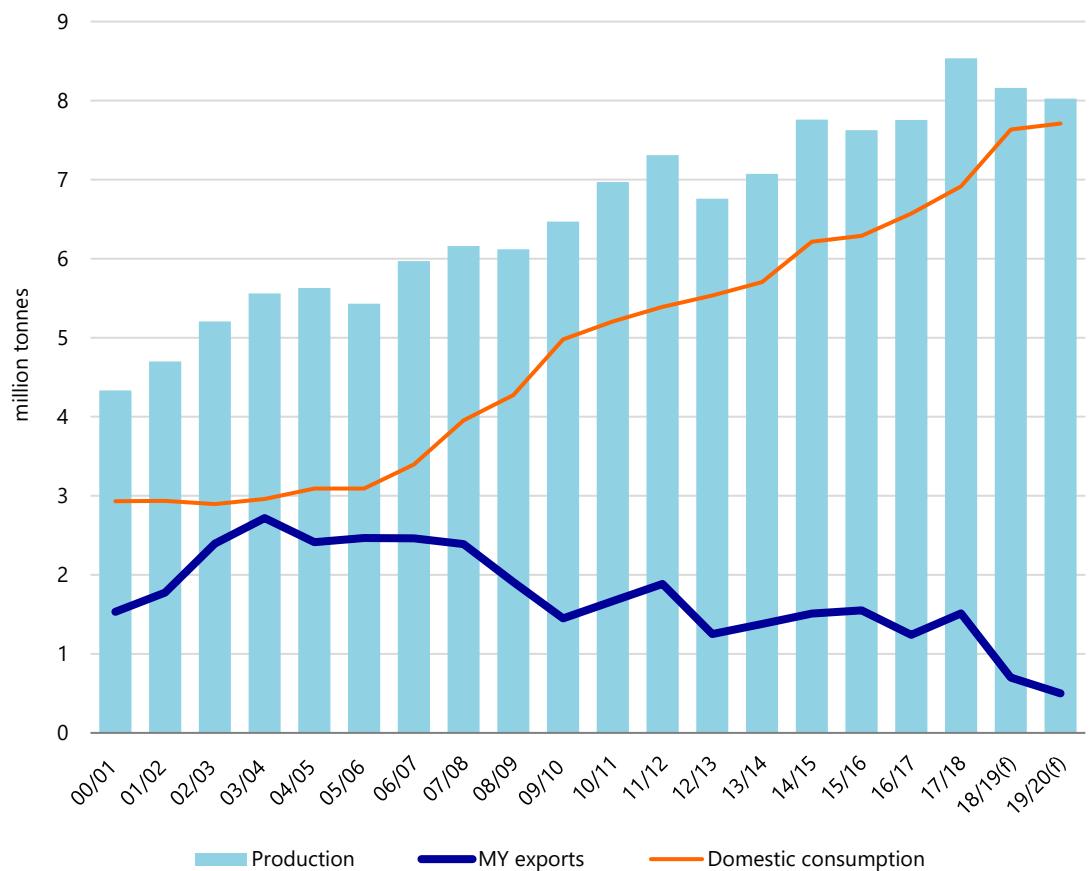
² Oilworld 2018

³ USDA, Rabobank 2019

An enduring price recovery in the cards

CBOT Soy Oil and MDE Palm Oil have shown strong recoveries since late 2018, pushing off three-year lows below US\$ 27/lb and MYR 1900/tonne, respectively. Rabobank sees potential for an enduring price recovery amid the emerging exportable capacity shortfall in Brazil and higher import demand in China. Brazil already faced strong demand for raw soybeans in 2018, which lowered exports of soy oil by 11% to 1.35m tonnes. In 2019, higher domestic biodiesel requirements (11%, up from 10% today) could decrease exports another 50% to 25-year lows. With the second largest exporter side-lined, global demand and prices of soy oil should move higher, in turn raising the competitiveness of palm, rapeseed, and sunflower oil. China, meanwhile, is reducing soybean imports in 2019 due to African swine fever, and will need to raise vegetable oil imports to cover its production deficit.

Figure 2: Brazilian soy oil exports will be cut by 50% amid higher biodiesel requirements⁴

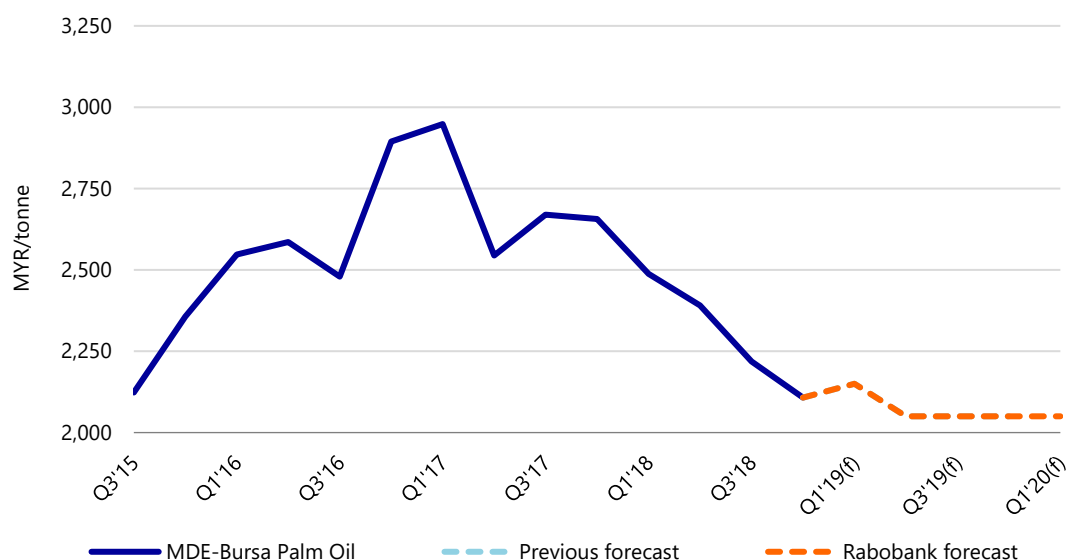


For MDE Palm Oil, typically strong year-end Asian demand has slowed monthly stocks growth in Malaysia and cut them in Indonesia. Rabobank will seek evidence of demand strength beyond March to justify a further rally, especially amid higher seasonal palm oil production and the anticipated EU ruling against allowing palm oil towards its biofuel targets. Still, the supply risk from El Niño (90% chance of occurring this winter, falling to 60% by spring⁵) and improving demand prospects will probably keep shorts side-lined and current levels supported near MYR 2200/tonne.

⁴ USDA, Rabobank 2019

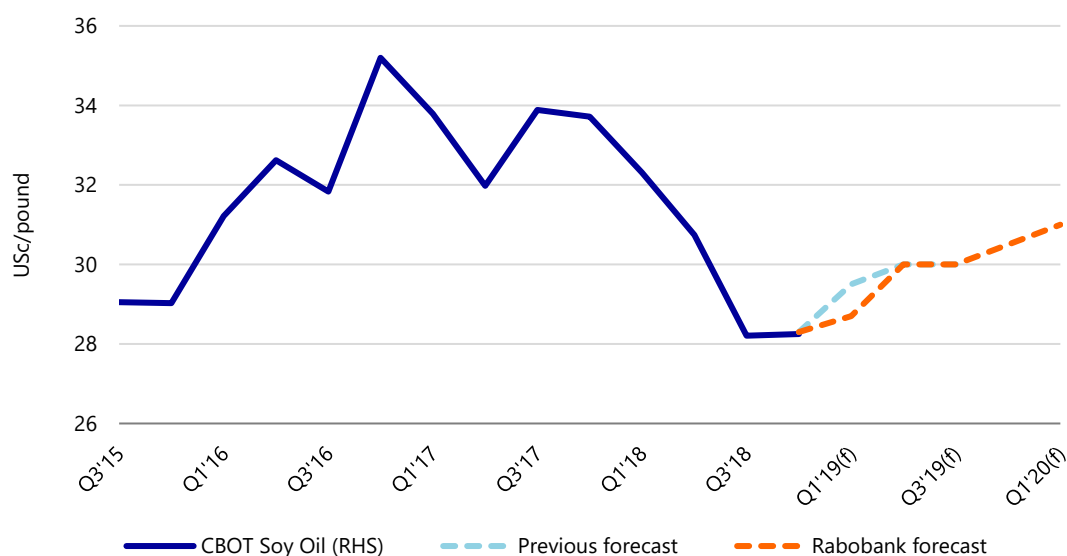
⁵ NOAA, 2019

Figure 3: Price forecast for MDE is restrained near MYR 2000 on higher annual production⁶



CBOT Soy Oil is having the best G&O performance of 2019, up about 10% YTD, supported by a US stock draw-down (-12% in 2018/19)⁷ and record fund short coverage. We laid out a case for CBOT Soy Oil bullishness in [the 2019 Outlook](#) that centred on a demand-led recovery. In a growing sign of consumption strength, NOPA⁸ reports over the last six months have consistently shown US soy oil disappearance to be larger than expected, despite record production. Moreover, Rabobank expects Brent price upside to spur further record biodiesel-based consumption of soy oil and support CBOT near USc 30/lb in 2019.

Figure 4: Price forecast for soy oil foresees growing support near USc 30/lb⁹



The key development for global vegetable oil fundamentals and prices will come out of South America. Rabobank expects strong Chinese demand for raw soybeans and higher domestic biodiesel requirements in Brazil to curtail soy oil supplies and shift further global demand to the US in 2019. This shift, alongside higher anticipated Chinese and global vegetable oil import demand, would help slow the current oversupply, and deliver further upside for prices in 2019.

⁶ Rabobank monthly estimates, January 2019

⁷ Rabobank 2019

⁸ US National Oilseed Processors Association, 2019

⁹ Rabobank monthly estimates, January 2019

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